No. 342

In the Supreme Court of the United States

OCTOBER TERM, 1944

ROBERT R. YOUNG, PETITIONER

v.

THE HIGBEE COMPANY, WILLIAM W. BOAG, AND J. F. POTTS

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SIXTH CIRCUIT

MEMORANDUM FOR THE SECURITIES AND EXCHANGE COMMISSION

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INTRODUCTORY STATEMENT

The Securities and Exchange Commission became a party in the District Court to the present proceeding for the reorganization of The Higbee Company under Chapter X of the Bankruptcy Act.[1] The Commission took no position in the District Court on the questions involved in the present appeal, nor did it participate in the appeal

[1] The Commission became a party pursuant to the provisions of Section 208 of the Bankruptcy Act (11 U. S. C., Section 608).

to the Circuit Court of Appeals. It is the Commission's view, however, that the decision of the Circuit Court of Appeals raises an issue of public importance in the administration of Chapter X of the Bankruptcy Act and, by analogy, in the administration of the reorganization provisions of the Public Utility Holding Company Act of 1935, which should be settled by this Court.

If the Commission is not properly to be regarded as a party respondent, in view of its nonparticipation on the appeal below, we ask the Court to regard this memorandum as a memorandum for the Commission *amicus curiae* in support of the petition.

OPINIONS BELOW

The opinion of the Circuit Court of Appeals is reported at 142 F. (2d) 1004. The opinion of the district court (R. 252–255) is not reported.

JURISDICTION

The decree of the Circuit Court of Appeals was entered on May 15, 1944. The petition for a writ of certiorari was filed on August 14, 1944. The jurisdiction of this Court is invoked under Section 240 of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether certain stockholders of a company in reorganization are accountable for sums received by them as consideration for the abandonment of

an appeal taken in the proceedings, where the appeal, if successful, would have benefited an entire class.

STATUTE INVOLVED

The petition for a writ of certiorari does not involve the construction of any specific provision of Chapter X of the Bankruptcy Act.

STATEMENT

A plan of reorganization for The Higbee Company in proceedings under Chapter X of the Bankruptcy Act was confirmed by order of the United States District Court for the Northern District of Ohio, Eastern Division, on October 17, 1941. The Securities and Exchange Commission, pursuant to Section 172 of Chapter X, had previously examined the plan and issued its advisory report finding the plan to be fair and feasible. An appeal was taken from the confirmation order by two first preferred stockholders of the debtor corporation, Potts and Boag (R. 181–182). The essence of their appeal was that the plan awarded too great a participation in the reorganized company to creditors' claims held by Bradley and Murphy, officers and directors of the debtor (R. 182–84).

On March 7, 1942, after the expiration of the time for appeal from the confirmation order, Potts and Boag sold their stock to Bradley and Murphy for a total consideration of $115,000 (R. 188–190).

On March 11, 1942, on stipulation of counsel the appeal was dismissed. The par value of the Potts and Boag holdings was $26,000 and at the time of the sale the market value was substantially less. (R. 188.) The difference between the price paid and the value of the stock was admittedly given as consideration for "selling the appeal" (R. 188).

The instant proceeding was instituted by another first preferred stockholder, Young, who applied to the bankruptcy court for an order either (a) authorizing him to employ counsel to institute proceedings on behalf of the debtor against Potts and Boag for an accounting and payment to the debtor of a sum equal to the difference between the fair value of the stock sold by Potts and Boag and the amount they received, or (b) directing Potts and Boag to pay over this sum to the first preferred stockholders of the debtor [2] (R. 2–4.) This application was denied by the District Court, and the Circuit Court of Appeals affirmed.

ARGUMENT

1. The court below impliedly conceded that had Potts and Boag taken their appeal in a representative capacity and not as individuals, it would have been inequitable not to share with other stockholders the consideration they received for abandoning the appeal. It is our position that in the

[2] The original application sought relief also against Bradley and Murphy but petitioner has not made them parties in his petition to this Court.

context of this reorganization proceeding the intention of Potts and Boag to sue as individuals was immaterial and that their duty to account flowed from the very nature of the appeal which they had "sold." If Potts and Boag had prosecuted their appeal to a successful conclusion there would have resulted a reduction of the amount of debt outstanding, and that would necessarily have accorded a more favorable participation for all stockholders who shared in the reorganized corporation. Whether or not they wished to act in their individual capacities, Potts and Boag could not attempt to improve their position in the reorganization except by improving the position of the other stockholders. Indeed, had they successfully prosecuted the appeal, they would have been entitled to allowances because their appeal benefited an entire class. *In re Keystone Realty Holding Co.*, 117 F. (2d) 1003, 1006 (C. C. A. 3, 1941). Furthermore, the taking by an individual stockholder of an appeal from an order approving a plan of reorganization necessarily subjects the entire class to the disadvantage of delaying consummation of a plan which other members may be prepared to accept. Thus, whether successful or unsuccessful, the individual security holder's appeal necessarily affects the entire class. Accordingly the appeal in this case, no matter how it may have been designated, was inherently an appeal on behalf of all other stockholders.

The Circuit Court of Appeals erroneously regarded it as of significance that the appeal pur-

ported to be one brought solely on behalf of Potts and Boag in their individual capacity.[3] In so holding we believe that the court below adopted an unduly narrow view of the nature of an appeal from an order confirming a plan of reorganization, as well as of the duties of a reorganization court as a court of equity to protect the integrity of the reorganization processes. As an illustration of the inherently representative character of such an appeal, irrespective of its label, we refer to the decision of this Court in *Sprague* v. *Ticonic National Bank*, 307 U. S. 161. That case involved a claim for counsel fees and litigation expenses on behalf of a depositor of a closed bank who had established her right to priority of her own deposit by a suit prosecuted in her individual behalf. By reason of *stare decisis* the litigation of her individual claim established the rights of an entire class of depositors similarly situated. In holding that the

[3] Petitioner Young also contends that the courts below erred in concluding that Potts and Boag were assuming to take their appeal only in their individual capacities. We are inclined to agree that their past connection with a protective committee should in itself preclude them from retaining for themselves the benefits from the sale of their securities and that they should not have been permitted to shuffle off expressly assumed fiduciary responsibilities merely because it happened to suit their purpose. *Cf. In re Reynolds Investing Co., Inc.*, 130 F. (2d) 60 (C. C. A. 3, 1942). Our memorandum, however, rests on what we conceive to be the inherent character of their appeal, and we do not here consider the equitable consequences of their attempted transformation from representatives to individual litigants.

individual nature of the suit did not bar her from receiving compensation from the fund payable to all other depositors similarly situated, this Court stated (at pp. 166–167):

> That the party in a situation like the present neither purported to sue for a class nor formally established by litigation a fund available to the class, does not seem to be a differentiating factor so far as it affects the source of the recognized power of equity to grant reimbursements of the kind for which the petitioner in this case appealed to the chancellor's discretion. * * * Whether one professes to sue representatively or formally makes a fund available for others may, of course, be a relevant circumstance in making the fund liable for his costs in producing it. But when such a fund is for all practical purposes created for the benefit of others, the formalities of the litigation—the absence of an avowed class suit or the creation of a fund, as it were, through *stare decisis* rather than through a decree—hardly touch the power of equity in doing justice as between a party and the beneficiaries of his litigation.

While the *Sprague* case determined the rights of an individual plaintiff against the beneficiaries of her action it seems clear that the inherently representative character of the action imposes equivalent obligation upon one into whose hands a fund has come. Consequently, whether the fund

has been obtained by suit or settlement such a person is under an obligation to account for that fund to the other members of the class who are beneficiaries of his litigation.

In selling their stock for the admitted purpose of selling the appeal Potts and Boag were in effect compromising the interests of all the debtor's stockholders. They realized much more than the improved position which they sought for themselves in the reorganized corporation and the compromise was therefore not merely of the gains which they sought for themselves but was necessarily a compromise of the gains which every stockholder participating in the reorganization would have received from a successful appeal. To permit Potts and Boag to retain the fruits of the compromise would not only violate the fundamental principle which calls for equal treatment of all security holders of the same class, but would permit them to profit extortionately from their abuse of the appellate process.

The refusal of a reorganization court to permit the unjust enrichment of individuals seeking a price for their consent to participate in a plan will not handicap the proper compromise of appeals from orders confirming reorganization plans but will merely require that the consideration received for the dismissal of such appeals must benefit all who would have benefited had an appeal been successful. Incentive to appeal will not be

eliminated since, as we have pointed out, those prosecuting such appeals are undoubtedly entitled to an allowance which reflects the extent to which the appeal benefits the estate or the class of investors affected.

2. Respondents made certain contentions in the court below not mentioned by the court in its decision. It is our view that these are without merit.

(a) It was contended below that Young should not succeed in his application because he, like other stockholders, did not object to the plan of reorganization which was confirmed. However, the acceptance by Young and the other stockholders of the plan of reorganization which was confirmed could not have affected their rights in any way had the appeal been successful and there is no reason why a different principle should be applicable to a compromise of that appeal.

(b) Respondent also pointed out in the court below that the purchase of the shares held by Potts and Boag was made because certain actions of Young had forced Bradley and Murphy to procure the abandonment of the appeal in order to retain their interest in The Higbee Company. We do not believe that either the motivating reasons for the sale of the securities or possible improprieties on the part of Young have any bearing on this application which seeks relief for the debtor or all of its first preferred stockholders. If Young was not a proper person to prosecute an

accounting suit for the estate or for the stockholders, the bankruptcy court could have ordered the trustee or some other satisfactory representative to do so. So long as the facts were properly before the court it was under a duty to require Potts and Boag to share the proceeds of the settlement of the appeal with those who would have benefited had the appeal been successful. In such a case the obligation is one which does not rest on the identity of the moving party; indeed the court was free to act on its own motion.

(c) It was also pointed out below that Young had been denied leave by the Circuit Court of Appeals to intervene in the appeal by Potts and Boag and to continue it at his own expense, and it was contended that the questions raised on the present application have thus already been adversely determined against Young. In connection with its order denying Young's application to intervene, the Circuit Court of Appeals gave no reasons for its action. Nor did that court in the instant appeal refer to its former order. We submit that the issues presented were not the same. On the prior appeal the court may have considered that Young was not a proper party to prosecute it, or it may have believed that the consideration paid was a reasonable amount for settlement of the controversy, without considering who the beneficiaries of the settlement should be.

3. The public importance of the question involved is derived from the very liberal provisions for security holder participation and appeal under

modern reorganization statutes.[4] Under the equity receivership procedure security holders' participation in the proceeding was dependent upon the discretion of the court in allowing intervention while dissenters' attacks on reorganization plans were based principally on a theory of fraudulent conveyance which permitted an unfairly treated creditor to exercise an individual, not a class, right to disregard the plan and to attach the debtor's assets in the hands of the reorganized corporation—or to reach assets otherwise inequitably diverted to stock-

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[4] See *e. g.*, Sections 169, 174, 179, and 206 of Chapter X (11 U. S. C., Sections 569, 574, 579, and 606), giving to any interested security holder a standing to be heard as of right upon the question of approval or confirmation of a plan. This statutory right to be heard has been interpreted as carrying with it a standing to appeal irrespective of whether formal intervention is permitted. See *In re Day & Meyer, Murray & Young, Inc.*, 93 F. (2d) 657 (C. C. A. 2, 1938); *In re Keystone Realty Holding Co.*, 117 F. (2d) 1003 (C. C. A. 3, 1941); and *Dana* v. *S. E. C.*, 125 F. (2d) 542 (C. C. A. 2, 1942).

See also Section 24 (a) of the Public Utility Holding Company Act of 1935 (15 U. S. C., Section 79x (a)), permitting a petition for review of a Commission order by any person or party aggrieved. Where plans of reorganization approved by the Commission under that Act are subject to approval by a District Court of the United States, the statute expressly provides for "notice and opportunity for hearing" (Section 11 (e), 15 U. S. C., 79k (e)). We believe that this authorizes participation by interested investors and carries with it rights of appeal from a district court order approving a plan comparable to those provided in Chapter X. *Otis & Co.* v. *S. E. C.*, certiorari granted, No. 81, present Term, involves such an appeal, although the record is open to the interpretation that Otis & Co. was accorded by the district court the status of an intervener.

holders.[5] By contrast to the equity practice limiting investor participation to discretionary intervention, the modern reorganization statutes permit any security holder to be heard on the fairness of the plan and to appeal. As we have stated above, it is our position on the merits that these liberalized provisions for investor participation must be interpreted as carrying with them concomitant responsibilities.

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[5] Instances of such methods of attack on unfair plans are *Chicago, Rock Island & Pacific R. R. Co.* v. *Howard*, 7 Wall. 392 (1868); *Louisville Trust Co.* v. *Louisville &c. Ry.*, 174 U. S. 674, 684 (1899); *Northern Pacific Ry. Co.* v. *Boyd*, 228 U. S. 482 (1913). As recently as the *National Radiator Co.* case, *First National Bank of Cincinnati* v. *Flershem*, 290 U. S. 504, 521 (1934), where this Court reversed the action of the courts below in holding that a court of equity had jurisdiction to appoint a receiver and provide for a receivership sale to reorganize a solvent corporation, it was indicated that the effect of the successful challenge to the plan was limited to such of the appellants as had objected to the lack of equity jurisdiction, but would not affect the status of approximately 95% of the holders of securities of the same class which had been deposited in support of the reorganization plan. The Court said:

"* * * The debenture holders who, by assenting to the Plan, cooperated with the Corporation and the Reorganization Committee, are in no position to complain that these petitioners will fare better than they. Compare *Davis* v. *Virginia Ry. & Power Co.*, 229 Fed. 633, 642 [C. C. A. 4]. Since the assets fraudulently conveyed far exceed the amount of the claims of all non-assenting creditors, none of these could have occasion to object to the payment to these petitioners in full."

Our position that any appeal challenging the fairness of a reorganization plan under Chapter X and similar statutes is necessarily a class appeal is based on the fact that the modern practice provides for direct rather than collateral attack on the order approving or confirming a plan.

The decision of the court below will tend to thwart one of the major objectives of bankruptcy reorganizations—the fair and equitable treatment of all who are entitled to participate in the estate. In addition, the decision will have the effect of encouraging participants in reorganization proceedings to object to reorganization plans and to prosecute appeals therefrom even where they have no basis for believing that such objections are sound, in the hope of exacting from other interested participants something more than the amount received by fellow members of their class. Thereby the same evils which Rule 23 (c) of the Rules of Civil Procedure guards against in other types of representative or derivative litigation[6] will become fastened upon reorganization procedure in situations like this where the application of the safeguards of that Rule may be doubtful. The just and expeditious reorganization of estates will consequently be impeded to the detriment of those on whose behalf the statute was enacted. These evils would not necessarily be confined to bankruptcy reorganizations. The experience of the Commission in administering the Public Utility Holding Company Act of 1935 has indicated that similar problems arise in connection with reorganizations under Section 11 of that statute.

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[6] *Cf.* Hornstein, *Problems of Procedure in Stockholder's Derivative Suits* (1942), 42 Col. L. Rev. 574, 583, *et seq.*; and Hornstein, *Legal Controls for Intracorporate Abuse—Present and Future* (1941), 41 Col. L. Rev. 405, 425–29.

CONCLUSION

For the reasons stated it is respectfully submitted that the petition for a writ of certiorari should be granted.

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